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RUEHUL/AMEMBASSY SEOUL PRIORITY 3018
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RUEHNH/AMCONSUL NAHA PRIORITY 3983
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C O N F I D E N T I A L SECTION 01 OF 02 TOKYO 003526

SIPDIS

STATE EAP, EEB/IFD/OMA AND EEB/EPPD; TREASURY IA FOR
FOSTER, WINSHIP, DOHNER; USTR FOR AUSTR CUTLER AND DAUSTR
BEEMAN;

E.O. 12958: DECL: 12/29/2018
TAGS: ECON EFIN PGOV EAP JA
SUBJECT: CABINET APPROVES SLIGHTLY CONTRACTIONARY REGULAR
FY2009 BUDGET

REF: TOKYO 3417

TOKYO 00003526 001.2 OF 002

Classified By: Charge d'Affaires James Zumwalt; reasons 1.4 (b/d)

¶1. (SBU) Summary: Japan's Cabinet approved the central government's draft regular FY2009 budget December 24, clearing the way for its submission to the forthcoming regular session of the Diet that begins January 5 and passage before the end of FY2008 (March 31, 2009). Proposed outlays of 33.5 trillion yen ($983 billion) represent an increase of 6.6 percent over the initial FY2008 budget. However, demonstrating the Japanese government's growing use of supplemental budgets, the proposed outlays are 0.4 percent or 0.4 trillion yen smaller than the revised FY2008 budget. Revenues for FY2009 are projected to decline a sizable 13.9 percent from the initial FY2008 estimate, a refection of Japan's worsening economic situation. The FY2009 budget continues the GOJ's practice of appearing to tackle its budget deficits while at the same time spending freely via supplemental budgets to meet political considerations. End Summary.

Overview of the General Account Expenditures

¶2. (SBU) Japan's latest revised budget for FY2009 (April 2009 - March 2010) projects total general account expenditures at 17.4 percent of GDP, essentially unchanged from 17.5 percent of GDP in the revised FY2008 budget. Most FY2009 spending is non-discretionary, including mandatory items such as social security spending (5.0 percent), projected debt service costs (4.0 percent of GDP), and revenue sharing with local governments (3.2 percent). Discretionary spending, including public works (1.4 percent of GDP), represents less than one third of total projected outlays.

Major Spending Categories

¶3. (SBU) The FY2009 debt service costs, a major mandatory spending item, are projected to total 20.2 trillion yen ($244 billion), up 0.4 percent from the initial FY2008 budget, thanks to continued low government bond yields. Also, social

security spending is budgeted to increase 14.0 percent in FY2009, reflecting a rise in government funding's share of the basic national pension scheme from the current one-third to one-half starting April 2009 (2.3 trillion yen, or $25 billion). Among discretionary items, FY2009 public works spending is set to increase 5.0 percent to 7.1 trillion yen ($79 billion), in part as a stimulus measure to counter rapidly deteriorating economic circumstances (ref). However, spending on ODA has been cut 4.0 percent from the initial FY2009 budget to 672 billion yen ($7.5 billion). This figure represents the tenth consecutive annual decrease in ODA funding. Additionally, a sizeable increase in reserves is reflected in the creation of a new 1 trillion yen ($11.1 billion) special reserve fund for unexpected economic events.

Overview of General Account Receipts

¶4. (SBU) The Ministry of Finance (MOF) projects FY2009 tax revenues at 46.1 trillion yen ($512 billion, or 9.0 percent of GDP), a drop of 0.7 percent from the revised FY2008 level. To cover this decline in tax revenues, MOF plans to issue 33.3 trillion yen ($367 billion) of new Japan Government Bonds (JGB) in FY2009, the largest JGB issuance in five years. As a non-tax receipt, MOF will also transfer approximately 4.2 trillion yen ($46 billion) in funds from the off-budget Fiscal Investment and Loan Program (FILP) Special Account to the general account budget. (Note: often termed "the second budget," the FILP finances government of Japan affiliated institutions as well as local governments, authorizes 15.9 trillion yen ($177 billion) for FY2009. End note.)

FILP Overview

¶5. (SBU) In addition to the funds transfer to the general account budget, the FY2009 FILP budget calls for total outlays of 15.1 trillion yen ($168 billion or 3.1 percent of GDP). This figure is up 14.4 percent from the initial FY2008 level, but down 3.6 percent from the revised level. FILP lending to government-affiliated financial institutions and public works implementing agencies is set to fall 2.1 percent and 32.8 percent from the revised FY2008 levels, respectively. In contrast, allocations to local governments will grow 21.4 percent in FY2009. Issuance of FILP bonds (12.0 trillion yen or $133 billion) and government guaranteed bonds (3.8 trillion yen or $42.2 billion) are the primary means for financing the FILP budget.

Fiscal Policy Shifts

¶6. (C) The Cabinet-approved FY2009 general account and FILP outlays do not signal an aggressive new fiscal policy, but suggest adoption of a moderately contractionary fiscal posture from the current fiscal year. This development is the result of the Aso administration's stated decision to pursue both medium to long term fiscal consolidation and a short term expansionary fiscal policy.

¶7. (C) Since FY2007, Japan has deployed a strategy of promoting fiscal consolidation mainly through cuts in government spending set by the medium term fiscal consolidation plan. (Note: the Koizumi Cabinet adopted a restrictive fiscal policy in July 2006 by setting specific targets for annual spending cuts over the five year period FY2007-2011 and calling for the GOJ to achieve "primary fiscal balance" by FY2011. End note.) During the first phase of compiling the FY2009 regular budget, the Cabinet assumed restrictive guidelines for budget requests from government ministries in July, as required by the medium term fiscal consolidation plan. Under the guidelines, ministerial budget spending requests, excluding social security, are

supposed to decline 0.2 percent from the initial FY2008 budget levels.

¶8. (C) Rapidly deteriorating economic conditions and the need to appeal to voters in advance of Lower House elections have led Prime Minister Aso to indicate repeatedly his top priority is to get Japan's economy moving even at the expense of increasing Japan's already large overall government deficit (currently about 180% of Japan's GDP). The Aso Cabinet, therefore, for the first time in seven years compiled two distinct supplemental budgets for FY2008 to fund measures committed under three separate economic stimulus packages--11.5 trillion yen on August 29; 26.9 trillion yen on October 30; and 43 trillion yen December 19, with 6 trillion yen of overlapping measures in the two most recent packages)-- without suspending the medium term fiscal consolidation plan. The two supplementals, plus the combined general account and FILP outlays reached 20.7 percent of GDP in FY2008, the highest level in four years.

¶9. (C) The long standing problem for Japan has been that while the fiscal consolidation plan binds spending under regular budget expenditures, it does not limit outlays under supplemental budgets. The FY2009 budget continues the GOJ's practice of appearing to tackle its budget deficits while at the same time spending freely via supplemental budgets to meet political considerations.
ZUMWALT